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211216Z Jun 05

UNCLAS SECTION 01 OF 05 OTTAWA 001860

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STATE FOR WHA, WHA/CAN (Holst); H(John Carter)

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FOR CHAIRMAN GOODLATTE FROM CHARGE D'AFFAIRES JOHN DICKSON

E.O. 12958: N/A

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SUBJECT: SCENESETTER: Your Visit to Alberta, Canada

1. I would like to take this opportunity to welcome you and House Agriculture Committee members and staff to Canada. I am sure that your visit will be productive and will help us advance the agenda on two of our biggest bilateral economic issues.

The Canadian Political Scene

2. Canada's core national problem - accommodating a significant French-speaking minority within British-style political institutions - dates back to the 1600's, and national unity issues in one form or another still provide the backdrop for much of what happens in Canadian politics. Federal-provincial relations can be fractious. Although provinces have tax authority, provincial leaders complain that the federal government's taxation powers exceed its responsibilities, and have sought to renegotiate fiscal and jurisdictional arrangements, either individually (e.g. on offshore oil and gas revenues) or by presenting a unified front against Ottawa (e.g. on health care and education funding).

3. Paul Martin was elected leader of the Liberal Party and became Prime Minister upon the retirement of Jean Chrtien in 2003. An election in June 2004 left the Liberals precariously leading the first minority government since 1980 with the uncertain support of the left-of-center New Democratic Party (NDP). They barely escaped an election in May after a tiebreaking vote by the normally nonvoting Speaker. Prime Minister Martin has pledged to call an election within 30 days after the report next fall of an

inquiry into a scandal over misuse of hundreds of millions of dollars in federal "sponsorship" funds in Quebec. All parties seem reluctant to go to the polls in winter when weather makes turnout uncertain, so a spring election appears more likely. At this point, it seems likely that such an election would yield another, smaller Liberal minority, and increase the number of seats held by the separatist Bloc Quebecois. The Official Opposition party, the Conservatives, are strongest in western Canada and in rural southern Ontario, but have made few inroads in urban Ontario or Quebec. The New Democratic Party of Canada is a tiny minority at this point but could be a dark horse in the next election.

Canada-US Relations: An Overview

4. Relations with the United States are always front and center for Canada. While our two countries have the world's longest undefended border and largest trading relationship, Canadians remain protective of their sovereignty and national identity and ambivalent about their overwhelming dependence on the U.S. economy. This sensitivity played into former PM Chretien's decision not to participate directly in the invasion of Iraq, and PM Martin's decision not to join the ballistic missile defense program. (The opposition Conservative Party disagreed with both of these decisions). Nevertheless, Canada has troops in Afghanistan and is working closely with the U.S. on peacekeeping in Haiti, and Canada leads the Iraq donor group.

5. Bilateral economic relations were strengthened by the free trade agreements in 1989 (FTA) and 1994 (NAFTA). Our two countries exchange over \$1 billion in goods and services each day, most of it without significant friction, and Canada currently enjoys a bilateral trade surplus with the U.S. of nearly \$70 billion USD. Canada is also the United States' largest foreign oil supplier, ahead of Saudi Arabia, and has the world's second largest petroleum reserves. In 2004, Canada exported over 1.6 million barrels of crude oil per day to the United States, or about eight percent of total U.S. consumption. Canadian gas and electricity exports also play a key role in ensuring the U.S. energy supply.

6. Despite our huge and largely trouble-free economic

relationship, ongoing irritants contribute to a perception here that the free trade agreements have failed to achieve what Canadian leaders promised: secure access to the U.S. market. Key Canadian trade concerns include:

--The inability of governments on both sides to restore pre-existing trade in beef and live cattle after BSE ("mad cow disease") was discovered in a few North American animals since 2002.

--"Border risk" - the perception that getting goods across the border is getting harder and more unpredictable (in a relationship where most goods still cross via land borders). While border bottlenecks are due primarily to the doubling of bilateral trade since 1989, security measures after September 11, 2001 and disruptions related to the SARS outbreak in 2003 have contributed to a fear that trade gains may be at risk.

-- The failure of a string of negotiations and litigation to put an end to a long-running trade dispute over softwood lumber, and accompanying irritations over the U.S. "Byrd Amendment."

17. On the U.S. side, we have expressed concern about a number of continuing or potential trade issues, including:

-- Canadian failure to ratify and enforce key treaties protecting intellectual property rights, and weaknesses in enforcement of existing Canadian IPR protections;

--supply management policies and other restrictions on agricultural trade;

-- continuing regulatory divergence, especially in the food area, that force U.S. producers to set up separate production runs to sell in Canada.

In addition, longstanding Canadian cultural restrictions on television and radio broadcasting, largely excluded from NAFTA coverage, continue to restrict the market for U.S. audiovisual exports.

The Security and Prosperity Partnership (SPP)

18. In his December 2004 visit to Ottawa, President Bush and Prime Minister Martin announced their intent to strengthen security and economic ties and improve North American competitiveness. Under the Security and Prosperity Partnership (SPP) announced in Waco last March, the three NAFTA partners are working to further strengthen the working of the North American economy in a range of incremental ways that do not require legislative action. The SPP incorporates our highly successful bilateral "Smart Border Action Plan" to improve security at the border while expediting low-risk traffic, and seeks to improve cooperation in key areas like food safety, motor vehicle regulation, and energy integration. However, the SPP will not directly address the lumber or beef disputes.

BSE

19. The ban on live cattle imports into the U.S. from Canada has been in effect for over two years. Following a full regulatory review process, USDA announced its revised rule allowing importation of ruminants and ruminant products and by-products from regions that pose a minimal risk of introducing BSE into the United States, to take effect on March 7, 2005. The rule would allow imports of Canadian cattle less than 30 months of age for immediate slaughter, and feeder cattle to be slaughtered before they reach 30 months of age. In addition, beef, including bone-in beef, from cattle less than 30 months could be imported from Canada.

10. However, legal action by the Ranchers Cattlemen Action Legal Fund-United Stockgrowers of America (R-CALF) halted implementation of the rule. On March 2, 2005, the United States District Court granted a preliminary injunction in the case of R-CALF versus the USDA. Hearings in the case are expected to start July 27. Canadian stakeholders are dismayed by the further delay in reopening the border, and some consider it to be yet one more example of supposed USG disregard for Canadian concerns.

11. Canadian government officials understand that the U.S. must follow the legal process, and have rejected industry calls for a WTO or NAFTA challenge to the continuing ban on live cattle imports in favor of an amicus brief in the R-CALF legal challenge. However, the Canadian response has become an issue in the struggle between the Liberals and Conservatives. Claiming that the GOC was not adequately defending cattlemen's interests, the Conservative Party sought independent status as an intervenor in the Montana court case. In the meantime, announcement of a "weak positive" test for BSE in a Texas cow has received broad

press coverage in Canada.

Progress on Canadian Restrictions on U.S. Cattle

12. Longstanding Canadian limits on U.S. exports of live cattle have contributed to dissatisfaction among parts of the U.S. industry with Canadian import policy and may play a role in some U.S. ranchers' opposition to lifting of the U.S. import ban. These issues are on the way to resolution following changes in Canadian policy sought by the U.S..

13. On October 22, 1997, the United States and Canada announced a prototype program called the North West Cattle Project, later known as the Restricted Feeder Cattle Project, to expedite shipments of live cattle from participating U.S. states to Canada. Under the agreement, U.S. live cattle exports were limited to a six-month shipping season from October 1 to March 31, which has been designated a low-risk vector season for bluetongue and anaplasmosis. In March 2004, Canada's Food and Inspection Agency (CFIA) announced the removal of testing requirements for anaplasmosis and bluetongue from all imported feeder cattle from the United States. Under this rule, U.S. feeder cattle from 39 states considered to have a low incidence of bluetongue are able to enter Canada directly without testing. Feeder cattle from the remaining 11 states, which are considered to have a high incidence of bluetongue, do not have to be tested provided they reside for at least 60 days in a low incidence state prior to export to Canada. Testing however, is still an option and should the feeder cattle be found free of bluetongue, the 60-day period will be waived. Historically, these high incidence states have not exported significant numbers of feeder cattle to Canada. In addition, the rule removed the six-month shipping restriction to allow exports throughout the year.

14. Canada's announcement on the restricted cattle program was long awaited, but it did not translate into immediate feeder cattle trade due to restrictions related to BSE. On March 29, 2005 Canada began allowing feeder cattle trade to resume under the March 10, 2004 rule. The rule lifts restrictions on imports of U.S. feeder cattle less than 30 months of age. When the proposed rule was published, CFIA also announced that efforts to expand access to U.S. breeder cattle would begin following the publication of a recently completed study.

15. U.S. exports of feeder cattle reached nearly 350,000 head in 2000, but declined to 132,484 head in 2002 due to the drought in western Canada. In 2003, U.S. exports of live cattle to Canada fell to 68,000 head and decreased to 28,000 head in 2004 due to the large number of cattle in Canada.

Softwood Lumber

16. Bilateral tensions over softwood lumber exports are now entering their third decade (or, some would argue, their third century) as a trade irritant. In the most recent round, WTO and NAFTA panels have affirmed our central argument that Canadian provincial timber practices, including stumpage fees and other measures, constitute countervailable subsidies. Nevertheless, a string of panel decisions critical of U.S. methodology and injury findings have strengthened the Canadian industry's (and the Canadian public's) perception that they are victims of unfair and illegal U.S. measures.

17. While litigation has yielded victories for both sides, it offers little hope of a long-term solution that adequately addresses both subsidy and market access issues for producers on both sides. The U.S. has consistently called for a long-term negotiated settlement that can address the underlying issues. While negotiations continue, U.S. and Canadian industries seemingly remain far apart in their view of what constitutes an adequate settlement. These differences are compounded by strong and sometimes bitter divisions in outlook and interest among Canadian provinces that Canadian federal negotiators have sometimes found it difficult to bridge. British Columbia, with the biggest share of exports, (and over \$2 billion in duty deposits to recover through a settlement) has generally been most disposed toward compromise. Ontario, Alberta, and Quebec have taken a harder line and pushed for aggressive litigation in NAFTA and WTO, while the Maritime provinces, currently logging primarily from private land and not subject to countervailing duties, have fought to remain outside any deal that involves numerical limitations.

Your Visit to Alberta: Overview

18. In a period of marked ups and downs in US-Canada relations, Alberta remains a bastion of relatively pro-American, free market sentiment. Alberta has a history of strong U.S. influence and is considered by many to be the

most "Americanized" province in Canada, due in part to the oil and gas boom that drew U.S. firms to the province in the early 1900's. Pro-U.S. sentiment has been sorely tested, however, by the suffering generated by the discovery of mad cow disease in Canada in 2003 and the continuing closure of the U.S. border to live cattle exports, as well as the dispute over U.S. duties on softwood lumber exports.

Alberta's Politics

19. Alberta is the only province in Western Canada governed by the right-leaning Progressive Conservatives (PC), the provincial affiliate of the national Conservative Party, with Canada's longest serving premier, Ralph Klein, at its head. In each of the provincial elections since 1992, and despite dramatic cuts to health and education, Klein and his Tory party have captured sizeable majorities, but in November 2004, amid growing accusations that Klein and his party had become complacent, the party lost 13 seats, several in their Calgary stronghold. Premier Klein maintains publicly that he will complete his term, but observers predict that he will step down later this year. Relations between Alberta and Ottawa are historically strained; Klein has, over the years, challenged Ottawa on a variety of issues, most notably provincial jurisdiction over resource ownership and health care. Alberta recently established its own liaison office at the Canadian Embassy in Washington, D.C. (led by former Alberta Energy Minister Murray Smith, who will attend Friday's roundtable meetings) to promote Alberta's interests directly to Congress and executive branch officials.

Alberta's economy

20. Alberta is a growing economic force in Canada, although its small population will continue to limit its political clout in comparison with Ontario and Quebec, Canada's population and industrial centers. Some 80% of Alberta's exports, valued at more than \$50 billion, head to U.S. markets. As Canada's energy capital, Alberta produces more than 80% of the country's oil and gas needs, providing the provincial government with multi-billion dollar budget surpluses. Alberta also supplies more than a million barrels per day of crude oil to the U.S., supplying 11% of our crude oil imports, or five percent of U.S. oil demand. The province also exports more than 2.6 trillion cubic feet of natural gas to the U.S., accounting for 62% of U.S. natural gas imports, and meeting about 12% of U.S. demand.

21. After energy and finance, agriculture is the third most important sector. Agri-food and forest product exports account for approximately \$2 billion each. Alberta is the largest cattle producer in the country and the ban on trade in live cattle, as well as a temporary ban on boneless beef exports to the U.S., due to BSE have cost Canada's cattle producers billions of dollars. All three prairie provinces have compensated cattle producers with millions (with some funds coming from the federal government), and Alberta has since introduced diversification plans to increase slaughter capacity in the province.

Softwood Lumber

22. While softwood lumber remains an important part of the provincial economy, Alberta is considered a small player with about 1.1 billion board feet in exports, well behind BC, Quebec, and Ontario. The forestry products sector, including pulp and paper and manufactured items as well as lumber, accounts for about 54,000 jobs. Alberta's softwood exports to the United States have declined substantially since the imposition of antidumping and countervailing duties following the end of the Softwood Lumber Agreement.

British Columbia: political overview

23. Premier Gordon Campbell's conservative Liberal Party (which is not affiliated with the federal Liberals) achieved a historic May 17 win in provincial elections as Campbell became the first B.C. premier in 22 years to win a second term. However, his government prevailed with a substantially reduced majority, and a decline in share of the popular vote from 58% in 2001 to 46%. Analysts attribute the decline in popularity to the party's cutting of social services; however, they were buoyed by a strong economic performance, driven by low interest rates, high commodity prices, aggressive deregulation, and tax cuts. BC Liberals have traditionally emphasized sound trade and economic ties with the US.

B.C.'s softwood industry

24. Your meetings with British Columbia officials will focus on the softwood lumber dispute. Lumber is the biggest industry in British Columbia, accounting for 17% of

provincial output and 14% of jobs. B.C. accounts for over half of Canadian softwood exports to the U.S. in the past three years and producers there are the biggest and, according to industry analysts, the most efficient of Canadian softwood producers. In 2003, B.C. forestry officials instituted reforms in timber pricing and contracting in coastal regions, leading to closure of a number of small mills and restructuring in the industry. B.C.'s forest reform plan envisions the eventual opening of 45% of provincial forests to market-based contracting and elimination of clauses obligating timber to be delivered to designated sawmills.

25. U.S. antidumping and countervailing duties have also spurred B.C. producers to streamline, through capital investment in more efficient and larger mills, and through mergers and acquisitions worth more than \$5 billion. Record lumber prices generated by housing booms in the U.S. and Canada have by and large allowed BC producers to increase export levels despite duty deposits of up to 27% and the 2004 rise in the Canadian dollar; B.C. shipped a record-breaking 11.4 billion board feet in 2004, outpacing exporters in other provinces. A provincial pine beetle infestation may further spur production as provincial forestry officials order emergency cuts in infested areas, temporarily increasing supply to sawmills.

26. Nevertheless, B.C. producers and provincial officials have been among the most eager proponents of a negotiated settlement of the AD and CVD cases that would offer them a more predictable commercial environment and a clear blueprint for acceptable reform that would eliminate the risk of future U.S. subsidy findings. They strongly supported the U.S. proposal made in December 2003 (eventually rejected by Canada) that would have imposed province-specific export quotas, in part because the proposed quota criteria would have locked in their increased market share relative to other provinces. At one point, B.C. officials also floated the idea of a province-specific agreement with the U.S. You can expect BC officials and industry representatives to argue that they have made substantial reforms and that we should negotiate a deal that would allow a return to full free trade on completion of their reform process.